

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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to: W. Ricky Stiff
Chief, Excise Tax Program

from: William V. Spatz *W. V. Spatz*
Senior Counsel
(Procedure & Administration)

subject: Request for Guidance – Form 720-TO/CS Reviews/Contacts and CBRS Contacts

You have requested our guidance regarding: (1) whether any of the activities described below rise to the level of an examination; and (2) whether any of the activities described below are subject to third-party contact requirements.

Analysis

Section 7605(b) provides that a taxpayer may not be subjected to unnecessary examinations or investigations and that the Service may inspect a taxpayer's books and records only once, unless the Service notifies the taxpayer that an additional inspection is necessary. The issue here is whether the Service's actions described below rise to the level of an examination.

Rev. Proc. 2005-32 describes four categories of certain Service contacts with taxpayers that are not deemed to be examinations, inspections of books of account or re-openings. Of the four conceptual categories set forth in Rev. Proc. 2005-32, the first and fourth categories are the ones that are potentially applicable to the factual scenarios that you have provided. The first and fourth categories are described in sections 4.03(1) and (4) of Rev. Proc. 2005-32, as follows:

(1) In the first category are narrow, limited contacts or communications between the Service and a taxpayer that do not involve the Service inspecting the taxpayer's books of account:

(a) looking at a tax return;

(b) matching information on a tax return with, or preparing a missing return from, other records or information items that are already in the Service's possession; or

(c) considering any records the taxpayer voluntarily provides to the Service to explain an apparent error on a tax return or to explain a discrepancy between

either a filed tax return or a substitute for return and information from third parties that is or may be used for the matching described in (b).

(4) A fourth category consists of contacts, compliance checks, examinations, or investigations of a taxpayer or a third party for one purpose, tax, or period (even if a dual purpose is present at the outset) that result in the Service obtaining information relevant or useful for a different purpose, tax, or period that may later either be matched with a return under the circumstances described in section 4.03(1) or may lead the Service to later open an examination or inspection for that different purpose, tax, or period. For example, a contact with a taxpayer, including an inspection of the taxpayer's books of account, for the purpose of investigating a possible violation of title 31 is not an examination, inspection, or reopening for any purpose under title 26.

Below we have analyzed the potential applicability of the first and fourth conceptual categories to each of the factual situations that you have presented. In addition, note that Rev. Proc. 2005-32 explicitly provides that the categories and examples of contacts in section 4.03 that are not examinations is not intended to be exhaustive, and that a contact that is not addressed in section 4.03 may not be an examination even though not listed.

Pursuant to section 7602(c), an officer or employee of the Service may not contact any person other than the taxpayer with respect to the determination or collection of the tax liability of such taxpayer without providing reasonable notice in advance to the taxpayer. Section 7602(c)(2) requires the Service to provide the taxpayer with a record of persons contacted upon the taxpayer's request. A third-party contact is defined as a communication that is: (1) initiated by an IRS employee; (2) made to a person other than the taxpayer; (3) made to help in the determination or collection of the taxpayer's tax liability; (4) discloses the taxpayer's identity to the third party; and (5) discloses the IRS employee's association with the Service. Treas. Reg. § 301.7602-2(b).

Below we have analyzed whether the section 7602(c) third-party contact requirements apply to each of the factual scenarios you have presented.

Excise Summary Terminal Activity Reporting System (ExSTARS) Scenarios

- One of the fuel strategies deals with comparing Form 720-TO information reported for each position holder against the position holder's Form 720 tax return. Telephone inquiries are made to the Form 720-TO filers to confirm the information reported on the form. These inquiries may identify potential noncompliance involving tax and possible penalty situations. The answers to these questions may impact the tax liability of the Form 720-TO filer and/or entities reported by the Form 720-TO filer. If these inquiries raise the potential of possible tax liability or penalties imposed upon a terminal operator, a referral is made to the field. Based on the information reported by the Form 720-TO filer and the position holder's Form 720 tax return, telephone contact

with the position holder may be necessary. If the Form 720-TO information reveals a potential discrepancy compared to the position holder's Form 720, a referral is made to the field.

The information matching and the informal efforts by telephone to confirm reported information or to obtain voluntary explanations of discrepancies in this information that you discussed, prior to a referral being made to a field examiner, appear to fall squarely within the first conceptual category of activities described in section 4.03(1) of Rev. Proc. 2005-32 that do not represent an examination by the Service. Further, as the questions and answers to the telephone inquiries, when made, may apparently relate to the potential tax liability of the person being contacted and to the potential tax liability of a third person, the Service would not be deemed to be contacting a person other than the taxpayer. Hence, the telephone inquiries you described would not be third party contacts within the meaning of section 7602(c).

- Another fuel strategy involves tracking barge shipments that leave a terminal. Form 720-TO information is used to develop a statistical sample of all barge removals from terminal reporting into ExSTARS. From the sample, a smaller set of shipments are selected. The individual selected barge shipments are sent to the field for review. The barge company will be contacted and asked to verify the information that was reported by the terminal operator. Additional information from the carrier will be secured on the individual shipment that will disclose the final destination. Shipments will be tracked to their final destination to determine whether the quantity and type of product that was removed from the terminal is the same as that received at its destination. In addition to the aforementioned, we will also verify whether the carrier has filed a Form 720-CS return and reported the sample transaction. If the carrier is not a Form 637 registrant, has not filed a CS return, or has not reported fuel movement, a referral will be made for possible assertion of penalties.

Using Form 720-TO information to develop a statistical sample, selecting a smaller set of shipments to review from that sample, and verifying whether a barge company/carrier has filed a Form 720-CS return reporting a transaction that is reflected in other information reported to the Service are each activities that appear to fall within the first conceptual category of activities described in section 4.03(1) of Rev. Proc. 2005-32 that do not represent an examination by the Service.

You also indicate that information on selected barge shipments will be sent to field Examination units in order to contact the barge companies, ask the barge companies to verify information that was reported by terminal operators, and to secure additional information by unspecified means from the barge companies/carriers. The barge companies/carriers so contacted by Examination field units may be liable for tax penalties if they failed to file appropriate Form 720-CS returns when required to do so. With respect to the barge companies (as taxpayers), these unspecified types of information gathering by field Examination units may not fit within the first conceptual category of activities described in section 4.03(1) of Rev. Proc. 2005-32 that do not represent an examination by the Service. We would require more information than you

have given us about what specific procedures and questions the field Examination units intend to use to obtain this information from the barge companies in order to opine on whether the Service's activity would cross the line into representing an examination of the barge companies. However, it appears that the Service's requests for further information from the barge companies (even if representing an examination as to these companies) would not represent part of an examination of the terminal operators, even if the Service has a dual purpose in contacting the barge companies, as discussed in the fourth conceptual category of activities described in section 4.03(4) of Rev. Proc. 2005-32 that do not represent an examination by the Service. As you have described the barge companies as the "taxpayers" being contacted as part of this strategy, the Service would again not be deemed to be contacting a person other than the taxpayer, so the contacts as you have described them would not represent third party contacts within the meaning of section 7602(c).

- A variation of the scenario is the development of leads from the Form 720-CS returns. To verify the correctness of a Form 720-CS return filed by the barge company/carrier, contact will be made with the terminal operator to obtain the bill of lading and third party gauge reports to verify the gallons loaded and off-loaded.

In this scenario, we first assume that the "taxpayer" is the barge company/carrier that filed the Form 720-CS return. Sending Examination field agents to the terminal operator to request these specific business records, rather than to explain any discrepancy or apparent omission from the Form 720-CS return, sounds like traditional, run of the mill examination activity that does not fit within any of the four conceptual categories described in section 4.03 of Rev. Proc. 2005-32 that does not represent an examination by the Service. If we assumed instead that the "taxpayer" in this situation is the terminal operator being contacted for these specific business records, the activity again appears to be traditional, run of the mill examination activity that should represent an examination. Whether this activity represents a "third party contact" depends on which party the Service is treating as the "taxpayer" with respect to the contact; if the taxpayer is the barge company/carrier, then it would be a third party contact, but it would not be a third party contact if the taxpayer is the terminal operator the Service is contacting.

- ExSTARS provides various general product codes (PC) with rather broad descriptions for filers to use when a product does not fit under any of the other specified PCs. An example is PC 092 (Other). In an effort to identify a product, telephone inquiries or questionnaires may be used by the Service to contact truck companies that remove product from terminals as reported by Form 720-TO terminal operator filers. The Service's ultimate goal in making these contacts with truck companies is to discuss specific load information, as reported by Form 720-TO terminal operator filers, with the truck company carriers to assist the Service with identifying the destination and ownership of the load. Non-bulk carriers will be asked by the Service to provide the name, address, phone number, and any other pertinent information regarding the previously unknown destination and owner of the shipment. The information provided by the carrier/transporter will be used by the Service, in part, to determine the tax and registration compliance of the owner's disposition of the product. If the product is

improperly classified by the terminal operator, a referral is also made on the Form 720-TO filer for possible assertion of the penalty for incorrect information.

With respect to the previously unknown ultimate owners of the shipments, whose identities may be learned through the Service's contacts with the carrier/transporter, the described activity does not represent a Service examination or a third party contact with respect to such previously unknown taxpayers. With respect to the terminal operators, who apparently may be liable for tax penalties for improperly classifying products on their Form 720-TO returns, the described contacts appear to represent both an examination of such terminal operators and to represent a third party contact with respect to such terminal operators under section 7602(c).

Currency & Banking Retrieval System (CBRS) Scenarios

- A fuel strategy has been developed for the importation of taxable fuels. The importer of record of taxable fuel as reflected on CBRS information is generally liable for tax. However, if the importer of record is acting in the capacity as an agent of the owner of the fuel, the actual owner of the fuel is liable for tax. Telephone inquiries are done to determine the correct party liable for tax and to confirm the accuracy of information obtained from CBRS. The correct entity liable for the tax is then queried to determine if they are properly registered, filling Form 720, and paying the tax. If the importer is not registered and/or not filing a Form 720, a referral is made for the potential tax liability, and penalty for failure to register.

The information matching and the informal efforts by telephone to confirm reported information or to obtain voluntary explanations of discrepancies in this information that you discussed, prior to a referral being made to a field examiner, appear to fall squarely within the first conceptual category of activities described in section 4.03(1) of Rev. Proc. 2005-32 that do not represent an examination by the Service. Further, as the questions and answers to the telephone inquiries, when made, may apparently relate to the potential tax liability of the person being contacted and to the potential tax liability of a third person, the Service would not be deemed to be contacting a person other than the taxpayer. Hence, the telephone inquiries you described would not be third party contacts within the meaning of section 7602(c).

If you have any questions regarding this request, please contact Jason Bremer at (202) 622-7951.